FOOTHILLS

Oil & Gas Ltd.

ANNUAL REPORT

DECEMBER 31, 1996

CORPORATE PROFILE

Foothills Oil & Gas Ltd. is a Calgary based, public oil and gas company. It is engaged in the production, acquisition and development of hydrocarbons in Canada. Management is currently pursuing growth through the acquisition of producing properties where it has identified future upside potential. The common shares of the Company are listed for trading on The Alberta Stock Exchange under the symbol "FH".

TABLE OF CONTENTS

Report to Shareholders 1
Operations Review 2
Auditors' Report. 3
Consolidated Financial Statements 4
Notes to Consolidated Financial Statements 7
Corporate Information. . . . . Inside Back Cover

ANNUAL GENERAL MEETING

Shareholders and members of the public who are interested in receiving more information are invited to attend the Company's Annual Meeting to be held at the offices of Macleod Dixon, 3700, 400 - 3rd Avenue S.W., Calgary, Alberta at 9:00 a.m. on Tuesday, June 17, 1997.

HIGHLIGHTS

		December 31, 1996		June 30, 1996
Production				
Oil and natural gas liquids (barrels per day)		**26**		**26**
Sales price (per barrel)		**$ 24.64**		**$ 22.76**
Natural gas (thousand cubic feet per day)		**89**		**210**
Sales price (per thousand cubic feet)		**$ 1.43**		**$ 1.13**
Barrels of oil equivalent per day		**35**		**47**
Reserves (barrels of oil equivalent)		**160,457** (1)		**166,897**
Financial				
Revenue (before royalties)	**$**	**141,712**	**$**	**104,694**
Cash flow from operations before changes in working capital	**$**	**23,748**	**$**	**32,147**
per common share (basic)	**$**	**-**	**$**	**0.01**
Net earnings (loss)	**$**	**(16,932)**	**$**	**(2,417)**
per common share (basic)	**$**	**-**	**$**	**-**
Capital expenditures	**$**	**63,550**	**$**	**703,758**
Working capital	**$**	**178,027**	**$**	**217,829**
Common shares outstanding (year-end)		**9,420,000**		**9,420,000**
Common shares outstanding (weighted average)		**9,420,000**		**5,406,667**

Notes:

1. Estimated proven reserves at December 31, 1996 based on reserve report of July 1, 1996 less production to December 31, 1996.

Report to Shareholders

This Annual Report covers the six month period from July 1, 1996 to December 31, 1996 reflecting the Company's change in corporate year end.

Foothills was started in September, 1993 as a Junior Capital Pool corporation as defined in the Alberta Securities Commission Policy 4-11. The Company completed its Major Transaction in late February, 1996. This process included the acquisition of proved producing oil and gas assets, infusion of new capital and changes in management and Board personnel with the aim of providing the Company with a solid foundation for future growth.

During the past six month period, the Company has produced an average 26 barrels of oil per day and 89 thousand cubic feet per day of natural gas from its Hayter and Woking properties. Revenue for the period was $141,712 with cash flow from Operations of $23,748.

Management is pursuing a strategy of growth through carefully planned and evaluated acquisitions with emphasis on quality proved producing properties. In the opinion of management and the Board, an ideal environment exists for the acquisition and subsequent exploitation of smaller asset packages in the Canadian oil and gas segment. The ability to identify and evaluate such opportunities will be the cornerstone of the Company's growth and success.

On March 25, 1997 the Company announced an agreement to acquire an interest in the Clive Area located in central Alberta. This acquisition is expected to add in excess of 25 barrels of oil equivalent per day to the Company with estimated reserves of approximately 78,000 barrels of oil equivalent. Closing of this transaction is expected in early June, 1997.

Management has turned its attention to the evaluation of several larger asset opportunities and is currently conducting necessary due diligence on these projects.

Management, directors and staff look to the upcoming year with enthusiasm.

William J. Kiff
President

OPERATIONS

For the period July 1, 1996 to December 31, 1996, Foothills averaged 26 barrels per day of oil and 89 thousand cubic feet per day of natural gas. Revenue before royalties for the period was $141,712 The Company received an average of $24.64 per barrel for its oil during the period and $1.43 per thousand cubic feet for natural gas. The average price per barrel of oil equivalent during the period was $22.01 per barrel.

Cash flow from operations for the period was $23,748 and the net loss was $16,932.

RESERVES

The Company's oil and gas reserves, all located in Canada, were evaluated by Henderson and Associates Petroleum Consultants Ltd. effective July 1, 1996.

Total oil reserves net to Foothills were 143,800 barrels. Approximately 85% of these total oil reserves were attributable to the Hayter property. Total natural gas reserves net to the Company were 231,400 thousand cubic feet with all of these reserves located in the Woking property.

During the six months since the report was prepared a total of 4,800 barrels of oil and 16,412 thousand cubic feet of natural gas have been produced.

COMPANY WORKING INTEREST RESERVES BEFORE ROYALTIES
as at July 1, 1996

	Crude Oil (barrels)	Natural Gas (mcf)	Present Value 15% DCF ($)
Proved			
Producing	80,400	231,400	$ 684,700
Non-Producing	0	0	$ 0
Total Proved	80,400	231,400	$ 684,700
Probable	63,400	0	$ 199,000
Total	143,800	231,400	$ 883,700

AUDITORS' REPORT

TO THE SHAREHOLDERS OF
FOOTHILLS OIL & GAS LTD.:

We have audited the consolidated balance sheets of Foothills Oil & Gas Ltd. as at December 31, 1996 and June 30, 1996 and the consolidated statements of loss and deficit and changes in financial position for the periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and June 30, 1996 and the results of its operations and changes in financial position for the periods then ended in accordance with generally accepted accounting principles.

Barr Shelley Stuart

CHARTERED ACCOUNTANTS

Calgary, Alberta

March 17, 1997

FOOTHILLS OIL & GAS LTD.

CONSOLIDATED BALANCE SHEETS

		December 31, 1996	June 30, 1996
ASSETS			
Current			
Cash and short term deposits		**$ 143,400**	$ 167,242
Accounts receivable		**54,702**	71,747
Inventory, prepaid expenses and deposits		**21,850**	42,573
		219,952	281,562
Property and equipment	*(Note 3)*	**716,846**	689,476
		$ 936,798	$ 971,038
LIABILITIES			
Current			
Accounts payable and accrued liabilities		**$ 41,925**	$ 63,733
Future abandonment and site restoration provision		**11,600**	7,100
Deferred income taxes	*(Note 4)*	**27,000**	27,000
		80,525	97,833
SHAREHOLDERS' EQUITY			
Share capital	*(Note 5)*	**886,228**	886,228
Deficit		**(29,955)**	(13,023)
		856,273	873,205
		$ 936,798	$ 971,038

See accompanying notes

On behalf of the Board:

Director

R. Sirrie

Director

FOOTHILLS OIL & GAS LTD.

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

		Six Months Ended December 31, 1996	Year Ended June 30, 1996
Revenue			
Petroleum and natural gas sales		$ 141,712	$ 104,694
Royalties, net of ARTC		(11,605)	(17,315)
		130,107	87,379
Expenses			
Production		61,338	35,343
General and administration		45,021	19,889
Depletion and amortization		36,180	30,464
Future abandonment and site restoration		4,500	4,100
		147,039	89,796
Earnings before income taxes		(16,932)	(2,417)
Provision for income taxes	*(Note 6)*	-	-
Net loss for the period		(16,932)	(2,417)
Deficit, beginning of period		(13,023)	(10,606)
Deficit, end of period		$ (29,955)	$ (13,023)
Loss per share	*(Note 7)*	$ -	$ -

See accompanying notes

FOOTHILLS OIL & GAS LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

		Six Months Ended December 31, 1996	Year Ended June 30, 1996
Net inflow (outflow) of cash related to the following activities:			
Operating			
Net loss for the year		$ **(16,932)**	(2,417)
Depletion and amortization		**36,180**	30,464
Future abandonment and site restoration		**4,500**	4,100
Cash flow from operations before working capital changes		**23,748**	32,147
Net change in non-cash working capital items	*(Note 8)*	**21,938**	(26,545)
Cash provided by operating activities		**45,686**	5,602
Financing			
Issue of common shares		**-**	619,000
Net change in non-cash working capital items	*(Note 8)*	**3,333**	(3,333)
Cash provided by financing activities		**3,333**	615,667
Cash available for investing		**49,019**	621,269
Investing			
Expenditures on property and equipment	*(Note 3)*	**(63,550)**	(442,577)
Property and equipment acquired from Milor Energy Inc. on acquisition of Milor Energy Inc.	*(Note 4)*	**-**	(261,181)
Future abandonment and site restoration provision assumed on acquisition of Milor Energy Inc.	*(Note 4)*	**-**	3,000
Deferred income taxes assumed on acquisition of Milor Energy Inc.	*(Note 4)*	**-**	27,000
		(63,550)	(673,758)
Net change in non-cash working capital items	*(Note 8)*	**(9,311)**	(21,135)
Cash used in investing activities		**(72,861)**	(694,893)
Decrease in cash during the period		**(23,842)**	(73,624)
Cash and short term deposits, beginning of period		**167,242**	240,866
Cash and short term deposits, end of period		$ **143,400**	$ 167,242
Cash flow from operations before working capital changes per share	*(Note 7)*	$ **-**	$ 0.01

See accompanying notes

FOOTHILLS OIL & GAS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1996

1. INCORPORATION

Foothills Oil & Gas Ltd. was incorporated under the Business Corporations Act (Alberta) on September 3, 1993 and classified as a Junior Capital Pool corporation as defined in the Alberta Securities Commission Policy 4-11. The Company completed its major transaction as approved at the Special and Annual General Meeting February 27, 1996 involving: (i) the acquisition of all of the issued and outstanding shares of Milor Energy Inc. ("Milor"), a private oil and gas company; (ii) the acquisition of an interest in certain oil and gas properties in the Hayter area of Alberta; (iii) the transfer within escrow of 1,000,000 Common shares of Foothills; and (iv) the private placement of 2,100,000 Common shares of Foothills.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared by management in accordance with generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period involves the use of estimates and approximations which have been made using careful judgment. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

Principles of Consolidation and Change of Year-End

These consolidated financial statements include the accounts and results of the Company and its wholly owned subsidiary Milor Energy Inc. for the period of February 27, 1995 to December 31, 1996 *(see Note 4)*.

Effective December 31, 1996 the wholly owned subsidiary was amalgamated into Foothills, and the financial year-end of the Company was changed from June 30th to December 31st. As such, the financial statements of December 31, 1996 include comparative audited consolidated financial statements for the 12 months ended June 30, 1996.

Property and equipment

Capitalized costs

The Company follows the full cost method of accounting for its petroleum and natural gas properties in accordance with the guideline issued by the Canadian Institute of Chartered Accountants whereby all costs related to the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in a Canadian cost centre and charged to income as set out below.

Capitalized costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-producing properties, costs of drilling both productive and non-productive wells, equipment costs and general and administrative costs directly related to exploration and development activities.

Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

Depletion and amortization

Depletion of petroleum and natural gas properties and amortization of production equipment is provided using the unit-of-production method based on estimated proved petroleum and natural gas reserves as determined by independent engineers. Amortization of production equipment is based on the cost of the assets net of estimated salvage and residual value. The relative amounts

of oil and gas production are converted at a ratio of ten thousand cubic feet of gas to one barrel of oil.

Office furniture and fixtures are carried at cost and amortized over the estimated useful lives of the assets at a rate of 20% calculated on a declining balance basis. Computer equipment is carried at cost and amortized over the estimated useful live of the assets at a rate of 30% calculated on a declining balance basis.

Ceiling test

The Company applies an annual ceiling test to the net carrying value of petroleum and natural gas properties to ensure that such costs do not exceed the amount estimated to be ultimately recoverable. The estimated amount ultimately recoverable includes the estimated value of future net revenues from production of proven reserves and the cost of unproved properties, net of impairment allowance, less future estimated production related general and administrative expenses, financing expenses, estimated future abandonment and site restoration costs and income taxes. Future net revenues are estimated using year end wellhead prices and costs without escalation or discounting, and the income, capital tax and Alberta royalty tax credit legislation in effect at year end. Any reduction in value, as a result of the ceiling test, is charged to operations.

Future abandonment and site restoration costs

The estimated cost of future abandonment and site restoration is based on the current costs and the anticipated method and extent of site restoration in accordance with existing legislation and industry practice. The annual charge, provided for on a unit of production basis, is accounted for as an expense. Abandonment and site restoration expenditures are charged to the accumulated provision account as incurred.

Inventories

Inventories of materials and crude oil are carried at the lower of cost, using the weighted average method, and net realizable value.

Income taxes

The Company follows the deferral method of tax allocation under which the income tax provision is based on the income reported in the accounts. Under this method, the Company makes full provision for income taxes deferred principally as a result of claiming capital cost allowance and exploration and development costs in excess of depreciation, depletion and amortization provided in the accounts.

Joint operations

Substantially all of the Company's exploration and development activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Segmented Information

The Company carries on the business of exploration for and development and production of crude oil and natural gas reserves. All of this activity is conducted in Western Canada and comprises a single business segment.

3. PROPERTY AND EQUIPMENT

December 31, 1996

	Cost $	**Accumulated depletion and amortization $**	**Net book value $**
Petroleum and natural gas properties	**636,686**	**53,500**	**583,186**
Production equipment	**117,490**	**7,200**	**110,290**
	754,176	**60,700**	**693,476**
Office furniture and equipment	**29,314**	**5,944**	**23,370**
	783,490	**66,644**	**716,846**

June 30, 1996

	Cost $	Accumulated depletion and amortization $	Net book value $
Petroleum and natural gas properties	574,336	24,500	549,836
Production equipment	117,490	3,500	113,990
	691,826	28,000	663,826
Office furniture and equipment	28,114	2,464	25,650
	719,940	30,464	689,476

During the six month period ended December 31, 1996, the Company capitalized general and administrative expenses of $62,350 (year ended June 30, 1996 - $36,767) directly related to acquisition, exploration and development activities.

As at December 31, 1996 petroleum and natural gas properties include $148,199 (June 30, 1996 - $106,953) relating to unproved properties which have been excluded from the depletion and ceiling test calculations.

The Company applied the ceiling test to the capitalized amounts of petroleum and natural gas properties and production equipment at December 31, 1996 using current prices, and has determined that no writedown is required.

4. ACQUISITION OF MILOR

The acquisition of Milor has been accounted for by the purchase method of accounting effective February 27, 1996. The initial cost of the acquisition to Foothills was satisfied by the issuance of 2,000,000 Common Shares at a price of $0.10 per share. The Company paid $46,059 of costs associated with the transaction.

This purchase price of Milor was allocated based on fair values as follows:

Petroleum and natural gas properties acquired	$248,681
Office furniture and fixtures acquired	12,500
Total property and equipment acquired	261,181
Cash acquired	3,773
Working capital assumed	11,105
Site restoration provision assumed	(3,000)
Deferred income tax assumed	(27,000)
Purchase Price	$246,059

5. SHARE CAPITAL

Authorized

Unlimited common shares of no par value

Unlimited non-voting, first and second preferred shares, issuable in series

The directors of the Company are authorized to determine the designation, rights, privileges, restrictions and conditions attaching to all of the preferred shares.

Common Shares Issued and Outstanding

	Number of Shares	$
Balance as at June 30, 1995	3,400,000	267,228
Shares issued pursuant to private placement (i)	2,100,000	210,000
Shares issued in connection with property purchase (ii)	1,500,000	150,000
Issued to the former shareholders of Milor on acquisition by the Company (iii)	2,000,000	200,000
Issued for cash pursuant to exercise of options (iv)	420,000	59,000
Balance, June 30, 1996 and December 31, 1996	9,420,000	886,228

(i) Pursuant to the terms of an Offering Memorandum dated January 26, 1996 the Company, by way of private placement, sold 2,100,000 common shares for gross proceeds of $210,000 on February 27, 1996.

(ii) On February 27, 1996 the Company issued 1,500,000 Common Shares at a price of $0.10 per share for a value of $150,000 as partial payment for a property acquisition *(refer Note 3)*.

(iii) Pursuant to the terms of the Foothills Information Circular dated January 26, 1996, Foothills acquired all of the issued and outstanding shares of Milor Energy Inc. on February 27, 1996 for an acquisition cost of $200,000 (excluding costs associated with the transaction). This amount was paid by the issuance of 2,000,000 Common Shares from treasury at an agreed value of $0.10 per share *(refer Note 4)*.

(iv) On February 27, 1996 the Company issued a total of 420,000 Common Shares to officers and directors pursuant to the exercise of stock options with 80,000 Common Shares issued at a price of $0.10 per share, and 340,000 Common Shares issued at a price of $0.15 per share.

Share Purchase Options

The Board of Directors of the Company adopted a Stock Option Plan for the Company (the "Plan"). Pursuant to the Plan, the Board of Directors of the Company may allocate non-transferable options to purchase Common Shares of the Corporation to directors, officers and employees of the Company and to consultants retained by the Company.

Under the Plan, the aggregate number of shares to be delivered upon the exercise of options granted thereunder may not exceed 10% of the issued Common Shares of the Company at the time of granting the options. Further, the aggregate number of Common Shares to be delivered upon exercise of options thereunder to any one individual shall not exceed 5% of the issued Common Shares of the Company Options issued pursuant to the Plan shall have an exercise price not less than that from time to time permitted by the stock exchange on which the Common Shares are listed.

At December 31, 1996 the Company has 855,000 outstanding common share purchase options with employees, officers, directors and consultants which were issued March 1, 1996. For these share purchase options, 815,000 are exercisable at a price of $0.10 per share and expire on March 1, 2001, and 40,000 are exercisable at a price of $0.14 per share and expire on September 25, 2001. During the six months ended December 31, 1996 new share purchase options for a total of 40,000 common shares were granted to a consultant.

Common Shares Held in Escrow

Under the requirements of the Alberta Securities Commission and the Alberta Stock Exchange, 2,000,000 Common Shares are held in escrow at June 30, 1996 and December 31, 1996. The escrowed shares will by released, upon written consent of the Alberta Securities Commission, as to one-third thereof on the first anniversary of the completion of the Company's major transaction. At the time of consent for the first release, approval of the second and third anniversary releases may also be granted to the shareholders.

6. INCOME TAXES

The following deductions are available for future income tax purposes:

	December 31, 1996 $	June 30, 1996 $	Annual Rate of Claim
Canadian development expense	-	1,078	30%
Canadian oil and gas property expense	**286,416**	312,364	10%
Share issue costs	**27,787**	19,233	20%.
Undepreciated capital cost	**110,962**	109,740	20%-30%
	450,844	442,415	

In addition, the Company has approximately $88,541 of non-capital loss carryforwards available for application against income for tax purposes, which expire commencing in 2001. The potential benefits relating to these available losses have not been recorded in the financial statements.

7. EARNINGS AND CASH FLOW FROM OPERATIONS BEFORE WORKING CAPITAL CHANGES PER COMMON SHARE

The calculations of earnings per share and cash flow from operations before working capital changes per share for December 31, 1996 are based on the weighted average number of shares outstanding during the period, which is 9,420,000 (year ended June 30, 1996 - 5,406,667).

Fully diluted earnings and cash flow from operations before working capital changes per Common Share have not been shown since they are not materially different from the basic amounts per Common Share.

8. CHANGES IN NON-CASH WORKING CAPITAL

Changes	**December 31, 1996**	June 30, 1996
Accounts receivable	**$ 17,045**	$ (70,173)
Inventory, prepaid expenses and deposits	**20,723**	(42,573)
Accounts payable and accrued liabilities	**(21,808)**	61,733
Total change in non-cash working capital items	**$ 15,960**	$ (51,013)
Associated with:		
Operating	**$ 21,938**	$ (26,545)
Financing	**3,333**	(3,333)
Investing	**(9,311)**	(21,135)
Total change in non-cash working capital items	**$ 15,960**	$ (51,013)

9. COMMITMENTS

The Company has future operating lease obligations for office premises until May 31, 2001. Future minimum lease payments as at December 31, 1996 are as follows: 1997 - \$21,720; 1998 - \$21,720; 1999 - \$21,720; 2000 - \$21,720; 2001 - \$9,050.

CORPORATE INFORMATION

DIRECTORS

Kevin A. Kelly
Managing Director
RBC Dominion Securities (Global) Limited
Nassau, Bahamas

William J. Kiff
President of the Company
Calgary, Alberta

Raymond A. Siwiec
President, First Canadian Energy Ltd.
Calgary, Alberta

OFFICE

Suite 1620, 734 - 7th Avenue S.W.
Calgary, Alberta T2P 3P8
(403) 264-7911
(403) 237-8105 (fax)

AUDITORS

Barr Shelley Stuart
Calgary, Alberta

OFFICERS

William J. Kiff
President

Charles W. Berard
Corporate Secretary

SOLICITORS

Macleod Dixon
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Montreal Trust Company of Canada
Calgary, Alberta

STOCK EXCHANGE LISTING

The Alberta Stock Exchange
Symbol: FH

Abbreviations

bbl	barrels
boe	barrels of oil equivalent
mcf	thousands of cubic feet
ARTC	Alberta Royalty Tax Credit